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In the Supreme Court of the United States

OCTOBER TERM, 1961

No. 711

AARON M. NADLER, PETITIONER

v.

SECURITIES AND EXCHANGE COMMISSION, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 27–30) is reported at 296 F. 2d 63. The findings and opinion of the Securities and Exchange Commission, dated December 23, 1960 (Pet. App. 32–50), have been published as Investment Company Act Release No. 3165.

JURISDICTION

The judgment of the court of appeals affirming the order of the Securities and Exchange Commission was entered on November 14, 1961 (Pet. App. 25–26). The petition for a writ of certiorari was filed on February 8, 1962. The jurisdiction of this Court is

invoked under Section 43(a) of the Investment Company Act of 1940, 15 U.S.C. 80a–42(a), and 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether the Commission was justified in declining after a full hearing to revoke a prior exemption order under the Investment Company Act, which permitted an exchange of securities between a registered investment company and its affiliate found to be fair and reasonable, solely because the order had been obtained by the investment company at a time when its directors had inadvertently been chosen contrary to Section 16(a) of the Act.

STATUTE INVOLVED

Pertinent provisions of the Investment Company Act of 1940, 15 U.S.C. 80a–1 *et seq.*, are Sections 6(c), 16(a), 17 (a) and (b) and 23(c). Section 6(c) is set forth at page 11, *infra*. The remaining sections appear in the appendix to the petition (Pet. App. 59–61).

STATEMENT

This case involves the validity of a Commission order of December 23, 1960, which held that there was no basis for revoking a prior order dated December 30, 1959 (Pet. App. 51–57). The latter order granted exemption from provisions of the Investment Company Act of 1940 to permit Securities Corporation

General (SCG), a registered investment company, to engage in certain stock transactions with Dynamics Corporation of America (DCA), its affiliate.

Section 16(a) of the Investment Company Act of 1940 requires that directors of registered investment companies shall be elected by security holders at an annual or special meeting called for that purpose. Petitioner suggests that because SCG's board of directors had not been elected in the manner required by Section 16(a) at the time of the application, the order of December 30, 1959, was void when issued and should have been so held when the infirmity was brought to the Commission's attention.

Before October 1959, DCA, a company engaged in the manufacture of electronic and related products, controlled SCG through the ownership of about 55 percent of its outstanding common stock. SCG in turn held 51.25 percent of the outstanding common stock of Anemostat Corporation of America. The bulk of the remainder of Anemostat stock, 32.8 percent, was owned directly by DCA. SCG's principal assets consisted of its holdings of Anemostat plus 4.95 percent of DCA's outstanding common stock.

The cross-ownership of SCG and DCA stocks, which was contrary to the legislative policy reflected in Subsections (c) and (d) of Section 20 of the Act, was eliminated in October 1959, when DCA sold its SCG common stock to six persons in 25,000-share

blocks.[1] The Commission was promptly informed of the transaction through ownership reports filed by DCA and by the new purchasers pursuant to Section 30(f) of the Act and Rule 30f–1 thereunder. At a meeting of the purchasers on November 4, 1959, called by the president of DCA (App. 317, 318), a letter was sent to the then directors of SCG requesting that a directors' meeting be held for the purpose of replacing the existing board of directors (App. 233–234, 520), whose members were nominees of DCA. The directors' meeting was held on November 11, 1959, and the directors then in office resigned *seriatim*, electing as directors three of the purchasers.

Following the November 4 meeting, DCA's president inquired by letter whether SCG would be interested in selling its 51 percent holdings of Anemostat common stock in exchange for the SCG preferred stock owned by DCA (App. 523). After negotiations from November 4 to December 2, 1959, SCG and DCA reached an agreement (App. 262–263, 523–525). This resulted in the application, pursuant to Sections 17(b) and 23(c)(3) of the Act, filed December 11, 1959. With respect to the former section, the application sought an exemption in connection with DCA's acquisition from SCG of 77,395 shares of Anemostat common stock. With respect to the latter section,

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[1] On various occasions during the preceding several years DCA had been advised by the staff of the Commission that it should divest itself of SCG common stock (R. 548–549, 604; App. 309, 348).

"R. —" refers to the certified transcript of record filed with the court of appeals; "App. —" refers to the appendix to petitioner's brief filed in the court of appeals.

the application sought an order permitting SCG to receive 4,757 shares of its preferred stock, as well as $155,820 in cash, from DCA as consideration for SCG's Anemostat stock. Acting on the advice of tax counsel SCG represented to the Commission that there was need for haste since, if the transaction could be consummated before the close of the year, SCG would benefit from a substantial tax loss carry-forward which would otherwise expire unused (R. 564, 570).

On December 16, 1959, the Commission gave notice of the filing of SCG's application in its Investment Company Act Release No. 2948. The Commission therein ordered SCG to mail a copy of the release to each of its preferred stockholders not later than December 18, 1959, and provided an opportunity for hearing to interested persons who might make a request for a hearing on or before December 28, 1959 (App. 18, 21).[2] This release was also published in the December 19, 1959, Federal Register, 24 Fed. Reg. 10319, in compliance with Section 40 of the Act and Rule O–5 thereunder. The record shows petitioner knew that SCG's application was pending before the Commission prior to the Commission's approval order of December 30, 1959, but that petitioner did not request a hearing (R. 1382–1383).[3] No need having been shown for a hearing, and

[2] Petitioner's statements (Pet. 6) that "[i]n fact, no common stockholder received notice until after the transaction was consummated," and (Pet. 22) that "[t]he public common stockholders never had a chance to * * * participate in any trial on the merits of the transactions * * *" approved by the December 30, 1959, order are undocumented.

[3] See 17 C.F.R. 270.0–5(c).

there being no outstanding request therefor,[4] none was held.

The Commission on December 30, 1959, issued an order granting the application. It found with respect to Section 17(b) that the proposed acquisition of the Anemostat stock by DCA was "consistent with the policy of SCG and with the general purposes of the Act and that the terms of the proposed transaction, including the consideration to be paid are reasonable and fair and do not involve overreaching on the part of any person concerned" (Pet. App. 37). With respect to Section 23(c)(3), the Commission found that the proposed purchase by SCG of its preferred stock "would be made in a manner or on a basis which does not unfairly discriminate against any holders of the preferred stocks" (*ibid.*). The transaction was consummated the next day.[5]

By letter of March 29, 1960, to the Commission, petitioner asserted that SCG's application had "misrepresented the facts and was a fraud on the Com-

[4] A request for hearing by letter, dated December 23, 1959, had been received by the Commission from a preferred stockholder of SCG, but this request had subsequently been withdrawn by telegram (R. 60–62, 64, 65).

[5] SCG held its regular annual stockholders' meeting on April 13, 1960. At this meeting a majority of the shares were voted to ratify the sale of the Anemostat stock as well as all acts taken by the officers and directors during 1959 and to the date of the meeting. The majority also voted to reelect the directors who had been elected at the November 11, 1959, directors' meeting. These directors then voted to ratify all acts taken by the officers and directors during 1959 and to the date of the meeting.

mission," that because of a violation of Section 16 (a) the filing of the application had not been legally authorized, and that as a result the Commission's exemption order of December 30, 1959, was void. Petitioner requested "advice as to the views of the Commission on the status of the aforesaid order, and whether or not there is any necessity for action on the part of Mr. Nadler to procure the official recognition of its invalidity" (R. 85–86).

The Commission instituted a private investigation on April 1, 1960 (R. 1374), and thereafter on April 12, 1960 (App. 12), ordered a public hearing to determine whether its exemption order of December 30, 1959, should be revoked. Petitioner, SCG, DCA, and the Division of Corporate Regulation of the Commission participated in extensive hearings[6] before a trial examiner, *inter alia*, as to the reasonableness and fairness of the transactions (R. 960–1050, 1140–1242). Briefs were filed and oral argument was heard before the Commission. On December 23, 1960, the Commission determined not to revoke its prior order.[7]

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[6] The hearing record filled some 1500 pages, 897 devoted to testimony of witnesses and the remainder to documentary exhibits (R. 362–1272, 1371–1952).

[7] On April 1, 1960, petitioner had instituted an action in the federal district court against SCG, its directors and DCA to set aside the stock transactions. When the Commission announced public hearings on the matter, the district court issued a temporary injunction preserving the status quo and staying the court proceedings. All parties, including petitioner, consented (Pet. 7). Upon issuance of the Commission's order of December 23, 1960, petitioner entered a stipulation providing for dismissal of his court action should the Commission's order be upheld by the court of appeals (Pet. 9).

It ruled (Pet. App. 42) that "the defect in the election of the board of directors makes our order voidable but does not make it void." Its opinion noted that before approving the Anemostat transaction, it had scrutinized the facts and found that the terms were "reasonable and fair and did not involve overreaching"; that "examination of the record in the instant proceedings indicates that no * * * showing has been made" "that material facts were withheld * * * or that there was fraud in other respects in the submission of the application for exemption"; and that had it originally been aware of the non-compliance with Section 16(a), it would not have reached "a different conclusion" (Pet. App. 44–45).[*] The Commission noted further "that the failure to comply with Section 16(a) was inadvertent; that since the purchasers of the SCG stock from DCA were the major beneficial owners of SCG they could have elected, and at the next regular meeting of stockholders did elect, their representatives as directors in compliance with the requirements of Section 16(a) * * *" (Pet. App. 48–49).

The court of appeals, in a *per curiam* opinion affirming the December 23, 1960, order, held that the Commission's findings "are supported by the evidence, [and] are crucial against the petitioner's claim" (Pet. App. 29).

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[*] The Commission also noted that it had been aware from the regularly filed ownership reports that the Anemostat transaction was entered into on behalf of SCG by persons who had just acquired their shares of SCG stock from DCA and had just become directors (Pet. App. 45).

ARGUMENT

This case presents no important issue warranting review. It involves only the question whether, in the particular factual circumstances here shown, the Commission was justified in refusing to revoke an order granting an exemption from certain provisions of the Investment Company Act of 1940. The court of appeals correctly upheld the Commission's refusal to revoke.

1. Petitioner contends that the Commission was required to revoke its prior approval of the Anemostat transaction upon receipt of notice of the non-compliance with Section 16(a). The contention finds no support in the terms of Section 16(a), which provide that "No person shall serve as a director * * * unless elected * * * at an annual or special meeting duly called for that purpose * * *," that "vacancies occurring between such meetings may be filled" without a meeting, provided two-thirds of the directors "shall have been elected * * * at such annual or special meeting * * *," and that in the event the number of regularly elected directors shall fall below a majority, a meeting for election of directors shall be held within sixty days "unless the Commission shall by order extend such period." Neither this section nor any other provision of the statute provides that all acts of a board whose members were inadvertently elected in violation of Section 16(a) are void or that Commission approval of an otherwise proper applica-

tion must be automatically rescinded when such noncompliance is brought to its attention.[9]

Under the facts of this particular case, the Commission was clearly justified in exercising its discretion not to revoke the exemption order of December 30, 1959, approving the Anemostat transaction. The Commission found (see *supra*, p. 8): the infraction was inadvertent; except for the defect in the election, the authorization of the application and the subsequent consummation of the transaction were legal and within the authority and power of the board; no material facts had been withheld at the time of the original application; and there was no fraud in other respects in the submission (Pet. App. 42–45). The Commission noted further that the provisions of Section 16(a) were designed particularly to prevent *seriatim* resignations and elections of directors "where the result is to deprive the beneficial owners of any voice in the conduct of the management, [and] where the insiders who arrange a shift in control do not own the requisite amount of voting shares necessary to effect a change in management at an annual or special meeting"[10] and that this condition

[9] Petitioner's contention that, under Section 47(b) of the Act, the transaction was rendered void is without merit. That section provides in pertinent part that every contract made in violation of any provision of the Act, and every contract whose performance involves such violation or the continuance of any relationship or practice in violation of the Act, shall be void. It relates only to contracts whose provisions in themselves, or whose performance, involve violations of other sections of the Act. Cf. *Graham-Newman Corp.*, 28 S.E.C. 133.

[10] Pet. App. 44 and n. 15; see Report of the Securities and Exchange Commission on Investment Trusts and Investment Companies, Part 3, p. 1878 (1940).

did not exist in the instant case, since the controlling group in SCG had a majority of the common stock of that corporation.

2. The Commission's action was consistent with the regulatory scheme established by Congress which wrote broad exemptive powers into the Investment Company Act. Thus, Section 6(c) specifically provides that the Commission:

> by rules and regulations upon its own motion, or by order upon application, conditionally or unconditionally to exempt any person, security, or transaction, or any class or classes of persons, securities, or transactions, from any provision or provisions of this title or of any rule or regulation thereunder, if and to the extent that such exemption is necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of this title.

It has been held that Section 6(c) authorizes the Commission to grant a retroactive exemption.[11] Here the Commission indicated that had it been aware of the non-compliance with Section 16(a) at the time it originally acted upon the application, the exemption

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[11] *Hennessey v. Securities and Exchange Commission*, 293 F. 2d 48, 50 (C.A. 3).

In a recent case the Commission was requested to grant and granted such retroactive exemption from several sections of the Act, including Section 16(a). See *In the Matter of Townsend Corp. of America, Townsend Management Co.*, Investment Company Act Releases No. 3288, 26 Fed. Reg. 6404 (July 1961) and No. 3296 (SEC File No. 812-1415).

order would nevertheless have been granted and that its refusal to revoke that order was consistent with the "public interest" and "the protection of investors"—the standards for an exemption under Section 6(c).

3. In view of the fact that petitioner (1) invited the Commission to recognize the invalidity of its order of December 30, 1959 (R. 85–86), (2) consented to a stay of his district court action against SCG, its directors and DCA pending the results of the Commission's hearing proceeding (Pet. 7), and (3) stipulated in the district court that he would dismiss that action upon affirmance of the Commission's order by the court of appeals (Pet. 24), his contention that he has been deprived of his day in court by reason of the Commission's action in declining to revoke its prior order is without merit. These facts also dispose of petitioner's contention (Pet. 11, 20–22) that the court of appeals' decision is in conflict with *Brown* v. *Bullock*, 294 F. 2d 415 (C.A. 2), *Brouk* v. *Managed Funds, Inc.*, 286 F. 2d 901 (C.A. 8), certiorari granted, 366 U.S. 958, or *Goldstein* v. *Groesbeck*, 142 F. 2d 422 (C.A. 2), certiorari denied, 323 U.S. 737. Those cases deal with implied rights of action under the Investment Company Act of 1940 (*Brown* and *Brouk*) and the Public Utility Holding Company Act of 1935 (*Goldstein*). This issue could only have been raised as a defense to petitioner's district court action and was foreclosed by his voluntary dismissal and decision to litigate the matter before the Commission.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted.

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